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Big Six: Trade Benefits of the US Economic Recovery

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An Intelligence Assessment

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EUR 84-10116
June 1984

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Big Six: Trade Benefits of the US Economic Recovery [redacted] 25X1

An Intelligence Assessment

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Big Six: Trade Benefits of the US Economic Recovery

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Key Judgments

Information available as of 1 May 1984 was used in this report.

The rapid economic recovery taking place in the United States is providing an important stimulus for other major industrial countries. Based on our econometric model, we estimate that for the Big Six countries in 1983 the US recovery alone accounted for:

- More than $7 billion in additional sales to the US market.
- Almost one-half percentage point higher real GNP growth—roughly one-fifth of their economic growth.
- Additional employment for 110,000 persons.

Canada and Japan, the two which rely most on the US market, reaped the largest gains, adding 0.8 and 0.6 percentage point, respectively, to their growth. Smaller gains accrued to the others, but the US recovery still accounted for a large share of their limited economic growth last year.

The strong dollar and the shape of the US recovery also helped boost Big Six economies. The Six along with other countries improved their competitive position in the US market because the dollar appreciated 25 percent from the level two years earlier (on an inflation-adjusted, trade-weighted basis). We believe this appreciation was the prime factor causing total US import volume in the present recovery to grow at twice the pace of that in the 1975/76 recovery—real GNP growth was comparable for the two periods. The Big Six further benefited because in the present recovery more US import demand has been directed toward manufactures—of which the Six are the major US suppliers—than in the previous recovery.

We believe the other major industrial countries will reap even more economic benefits over the next few years if the US recovery continues. To estimate the impact, we used the Data Resources, Inc. (DRI) forecast for US GNP growth of 5.3, 3.2, and 2.6 percent for 1984, 1985, and 1986, respectively, in our econometric model. The results indicate that by 1986 a US recovery of that pattern compared with zero US growth for the period would benefit the Big Six countries by:

- Raising their exports to the United States by $100 billion, up 31 percent in value and 29 percent in volume terms.
- Increasing real GNP growth by 2 percentage points.
- Creating nearly three-fourths of a million jobs, reducing their combined unemployment rate by 0.6 percentage point.

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While the US recovery can provide important seed money to help the other countries, it is insufficient to provide a solution to their fundamental economic problems, particularly those faced by the major West European Allies. US trade patterns favor Japan and Canada over West European countries, who are the biggest critics of US economic policy. Protectionist pressures in Europe are not likely to abate because the trade gains are not benefiting the declining industries. Furthermore, although the Europeans recognize the positive benefits of the US recovery, they still believe the negative impact of high US interest rates more than offset them.

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Trade Trends in 1983

Last year, the United States was the fastest growing major export market for the Big Six industrialized countries.[1] As a result, increased foreign sales to the US market provided an important stimulus to economic activity in those countries. The rapid US economic recovery, coupled with a strong dollar that favored foreign goods, helped the Big Six boost exports to the United States by more than $14 billion in 1983—a 12-percent increase over the previous year in dollar terms (see table 1) and a sharp rebound from 1982 when their exports declined by almost 2 percent. In volume terms, Big Six exports to the US market were even more buoyant, up 15 percent from 1982 levels (see table 2).

Except for Canada, which accounts for only a minor share of Big Six exports, other Big Six export markets posted marginal gains or actual losses over 1982. Sluggish growth in the West European economies hampered their import demand. While Japan was able to boost its market penetration, the four major West European countries experienced nominal declines and modest volume gains in sales to their neighbors—a major factor for these four countries because 61 percent of their exports go to the West European market. Big Six exports—both by value and volume—fell to the LDCs last year as declining oil revenues, slack commodity prices, and debt servicing problems forced the LDCs to trim imports sharply. Despite respectable percentage increases, the Communist countries account for a relatively small share of Big Six exports. Dollar gains scored by France and Italy in this market, however, rivaled those achieved with the United States.

Trade gains in the US market were not evenly distributed. Canada and Japan, the two largest US trading partners, posted the most rapid volume growth followed closely by France, West Germany, and then Italy. Canada is closely linked to the US economy, particularly in the rebounding auto and housing markets, while Japan is more competitive overall than Western Europe in the US market. A $1.2 billion drop in US oil imports from the United Kingdom was the cause of the meager UK volume gains and the decline in total nominal exports to the United States. This pattern of gain closely parallels the importance of the US market for each of the Big Six countries.

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Most of the increase in Big Six exports to the US market was in manufactures. US imports of transport equipment, machinery, nonferrous metals, and chemicals increased the most (see table 3). Canada, with special links to the US auto industry, scored the largest gains in transport equipment. Japan's export performance was strongest in machinery, capturing over 80 percent of the increase in US machinery imports, followed by autos as higher priced models offset Tokyo's quantitative restraints. Sales of Japanese office and ADP equipment to the United States were up $1 billion over the previous year. On the other hand, Japan absorbed over half of the 40-percent cut in US steel imports from the developed countries that resulted from the combination of slack US demand and voluntary export agreements. British gains in manufactures resulted almost solely from its role as a nonferrous metals broker. The United Kingdom was the only Big Six country to lose ground in the US machinery market last year. West Germany suffered the second-largest drop in steel sales to the United States as a result of the EC voluntary restraint agreement but scored gains in other manufactures categories. The overall increase in exports of manufactures by France and Italy were modest and not highly concentrated. In contrast to small French increases in auto exports as price competitiveness improved, Italian auto sales in the US market fell because of the pullout of Fiat.

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[1] The Big Six countries are Japan, West Germany, France, the United Kingdom, Italy, and Canada.

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Table 1
Big Six: Export Performance, 1983 [a]

Billion US $

	Exports to						
	World	United States	Japan	Western Europe	Canada	LDCs	Communist
Big Six	**652.3**	**132.8**	**9.2**	**289.4**	**7.8**	**149.7**	**30.5**
Change over 1982 *(percent)*	−0.2	12.4	3.0	−1.7	17.7	−7.0	8.3
Japan	**147.0**	**42.3**		**23.1**	**3.6**	**60.7**	**9.4**
Change over 1982 *(percent)*	6.2	15.7		6.8	25.6	−0.5	10.1
West Germany	**169.4**	**12.8**	**2.2**	**112.1**	**1.2**	**25.3**	**8.9**
Change over 1982 *(percent)*	−4.0	10.3	2.8	−3.6	18.5	−12.9	4.6
France	**94.9**	**5.7**	**1.1**	**55.1**	**1.0**	**22.3**	**4.0**
Change over 1982 *(percent)*	−1.8	9.4	0.0	−0.9	37.5	−9.4	20.9
United Kingdom	**91.6**	**12.7**	**1.2**	**51.2**	**1.4**	**18.5**	**1.8**
Change over 1982 *(percent)*	−5.6	−2.8	1.3	−0.8	−5.6	−15.6	−3.0
Italy	**72.7**	**5.5**	**0.8**	**41.4**	**0.6**	**17.4**	**3.2**
Change over 1982 *(percent)*	−1.0	5.2	4.2	−1.4	13.6	−6.1	16.8
Canada	**76.7**	**53.8**	**3.9**	**6.4**		**5.5**	**3.3**
Change over 1982 *(percent)*	7.6	15.7	4.2	−8.0		−15.0	−0.6

[a] Column totals may not add due to rounding.

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Table 2
Big Six: Export Volume Growth, 1983

Percent change 1983/1982

	Exports to						
	World	United States	Japan	Western Europe	Canada	LDCs	Communist
Big Six	3.8	15.0	6.5	3.1	22.4	−3.5	12.6
Japan	8.6	18.3		9.3	28.4	2.8	12.6
West Germany	0.3	15.2	7.3	0.6	23.7	−9.0	9.2
France	3.6	15.4	5.5	4.5	45.1	−4.4	27.6
United Kingdom	0.3	3.2	7.5	5.3	0.2	−10.4	3.0
Italy	5.2	11.8	10.8	4.5	20.8	−0.2	24.1
Canada	8.4	16.5	4.9	−9.4		−13.4	0.1

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Table 3
United States: Imports of Manufactures From Big Six Countries, 1983

	Big Six	Japan	West Germany	France	United Kingdom	Italy	Canada
Total manufactures *(million US $)*	**101,870**	**40,356**	**11,750**	**4,916**	**7,065**	**4,625**	**33,157**
Change over 1982 *(percent)*	10.0	8.8	5.5	6.6	12.7	3.6	14.3
Chemicals *(million US $)*	**7,000**	**1,090**	**1,227**	**879**	**1,020**	**301**	**2,483**
Change over 1982 *(percent)*	10.4	25.9	13.0	34.0	28.5	18.5	−8.5
Textiles and clothing *(million US $)*	**2,226**	**912**	**153**	**198**	**213**	**518**	**232**
Change over 1982 *(percent)*	10.8	16.6	31.9	10.6	14.5	17.2	26.1
Iron and steel *(million US $)*	**4,203**	**1,940**	**562**	**420**	**166**	**207**	**908**
Change over 1982 *(percent)*	−40.1	−46.2	−51.8	−28.0	−44.7	−63.8	1.6
Nonferrous metals *(million US $)*	**3,953**	**383**	**288**	**99**	**1,036**	**71**	**2,077**
Change over 1982 *(percent)*	57.2	26.4	30.3	11.2	319.4	102.9	28.1
Machinery *(million US $)*	**28,375**	**15,336**	**3,698**	**1,110**	**2,028**	**974**	**5,229**
Change over 1982 *(percent)*	14.4	23.9	10.3	14.7	−15.4	9.3	8.9
Transport equipment *(million US $)*	**36,237**	**14,811**	**4,080**	**1,061**	**984**	**382**	**14,919**
Change over 1982 *(percent)*	14.2	9.7	10.6	−3.5	17.3	4.4	22.0
Scientific, photographic, optical instruments *(million US $)*	**3,528**	**2,064**	**489**	**199**	**279**	**107**	**391**
Change over 1982 *(percent)*	10.6	13.2	3.2	16.4	−6.1	23.0	15.3

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Impact of the US Recovery

We estimate that the increase in US imports from the Big Six caused by the US economic recovery alone helped boost Big Six real GNP growth last year by almost one-half percentage point and employment by 110,000 persons (see table 4 and inset). Since economic growth among the Six averaged only 2.0 percent in 1983, the US recovery generated the equivalent of almost one-fifth of the economic expansion in these countries. Canada and Japan received the greatest economic benefit from the US recovery, while West Germany and France accrued the least.

According to the CIA's Linked Policy Impact Model [2] (LPIM), the US recovery accounted for the equivalent of about three-fourths of the 8-percent increase in nominal US imports from the Big Six countries last year. The rest was caused by other factors, principally the appreciation of the dollar, which made foreign goods more price competitive. In volume terms, US growth had a similar impact—US import volume from the Big Six was 6 percent higher than it would have been if the US economy had not grown at all. Of the $7.2 billion increase in Big Six sales attributable to the US recovery, Canada and Japan combined accounted for $5.1 billion, reflecting their large share of the US market. West Germany and the United Kingdom together took two-thirds of the remaining $2.1 billion.

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The impact of the US recovery on individual Big Six countries' real GNP varies primarily according to the relative importance of the United States as an export

[2] The Linked Policy Impact Model is an econometric model of the world. It integrates individual 200-equation economic models of the seven major industrialized economies—West Germany, France, Italy, the United Kingdom, Canada, Japan, and the United States—and smaller models of regional economic groups—the smaller developed countries, OPEC, and non-OPEC LDCs; the centrally planned economies are represented by trade-flow equations.

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Table 4
Big Six: Impact of US Recovery, 1983[a]

	Big Six	Japan	West Germany	France	United Kingdom	Italy	Canada
US imports from the Big Six (*billion US $*)	7.2	2.3	0.7	0.4	0.7	0.3	2.8
US import volume from the Big Six (*percent*)	6.0	6.0	6.0	5.9	6.7	6.0	5.9
Employment (*thousand*)	110	8	28	21	22	11	20
Real GNP (*percent*)	0.4	0.6	0.2	0.2	0.4	0.3	0.8
Actual GNP growth (*percent*)	2.0	3.1	1.3	0.7	3.5	−1.2	3.0

[a] Difference between the actual results for 1983 and an LPIM scenario assuming zero US GNP growth in 1983.

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market for each country.[3] The Canadian and Japanese economies received the largest stimulus because the United States accounts for 70 and 30 percent, respectively, of their exports. Of the four West European countries, UK real GNP advanced the most since the US share of total British exports is about 14 percent, compared to 8 percent for West Germany and Italy, and 6 percent for France. Despite the relatively small influence on the French and Italian GNPs, the US recovery accounted for a sizable share of their actual GNP performance; for France, the United States contributed the equivalent of almost one-third the 1983 growth, while, for Italy, the US contribution helped cushion an overall economic decline.

For 1983 the employment effects of US recovery are relatively small because of the lagged impact of GNP growth on job creation. The largest employment gains in absolute terms were felt by West Germany, the United Kingdom, France, and Canada. After taking account of the different size of the labor force in each country, however, the impact on the unemployment rate is about the same for most of the Big Six. We estimate that the rate was roughly 0.1 percentage point less than it otherwise would have been. Only in Canada was the unemployment rate pulled down more, an estimated 0.2 percentage point, because of the relatively larger GNP impact of the US recovery.

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Other Influences on Trade

The appreciation of the dollar over the 1981-83 period probably has been the single most important other factor helping to boost Big Six exports to the United States. As a result of the strengthening of the dollar, the price of Big Six exports dropped relative to the price of US goods, thereby improving the competitive position of the Six in US markets and leading to expanded exports. The net effect of the strong dollar during 1981-83 was to channel a larger share of the increase in US aggregate demand into imports.

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We believe the appreciation of the dollar largely accounts for the more rapid pickup in US import volume that has occurred in the present recovery compared to the 1975/76 recovery. Although the pace of real GNP growth has been about the same for the two periods, during the first four quarters of the 1983 recovery, US import volume rose 28 percent compared to only a 14-percent rise during the first four

[3] Exports account for about 25 percent of GNP for all the Big Six countries except Japan, where it is only 16 percent.

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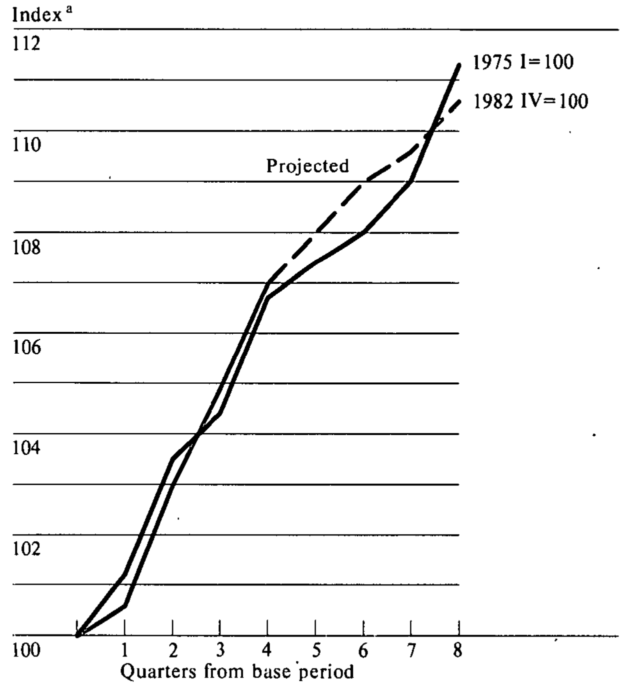
Estimating the Impact of the US Recovery

We used the CIA's Linked Policy Impact Model (LPIM) to estimate the impact of the US recovery on Big Six exports and economic growth. The model enables us to isolate the effect of US economic growth on international trade from other factors which influence trade patterns, such as the value of the dollar. To estimate this impact, we ran the LPIM assuming US real economic growth was zero in 1983 and left all other independent variables unchanged from the actual results that year. The difference between actual trade, employment, and GNP for 1983 and the simulated results is the measure of the US recovery's impact. Since the model links all the Big Six economies, this result captures not only the direct impact of increased exports to the United States, but also the indirect effect of increased exports to each other (and to the rest of the world) spurred by the change in US growth. 25X1

Figure 1
United States: GNP Growth During Economic Recovery



[a] Based on 1980 prices.
Source: Projected data from DRI (control 032684).

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quarters of the previous recovery (see figures 1 and 2). One of the major differences between the two cycles was the movement of the dollar prior to the start of each recovery. At the beginning of the 1983 recovery (the fourth quarter of 1982), the dollar—on a trade-weighted, inflation-adjusted basis—stood 25 percent above its level two years earlier (see figure 3). In other words, foreign competitors in the US market started the recovery with a 25-percent improvement in their competitive position compared to 24 months earlier. At the start of the 1975/76 recovery, however, the dollar stood 7 percent below its level of two years earlier—foreign competitors had lost some competitiveness.

Big Six exports to the United States also have grown more rapidly in the present recovery compared to 1975/76 because more US import demand has been directed toward the Big Six than to other countries, the opposite of what occurred in 1975/76. Most of the growth in US imports last year came in manufactures which favored Big Six exporters. In the previous recovery, however, US import demand for LDC oil rebounded fairly quickly in contrast to the current period when the effects of conservation and use of alternative fuels are holding down US oil imports. Moreover, US demand for many LDC raw materials is still at depressed levels. 25X1

Prospects

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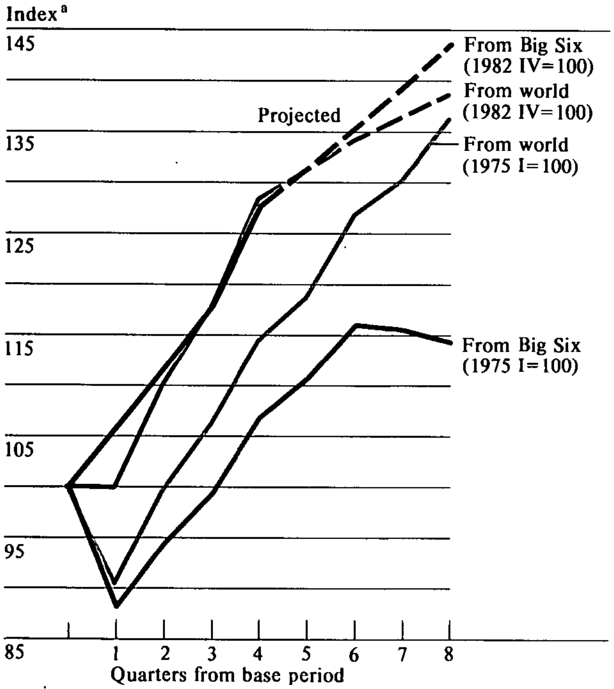
We believe that over the next few years the Big Six countries will reap even more economic benefit from the continued US recovery than they did in 1983. Over the 1984 to 1986 period, we estimate Big Six annual economic growth will average 0.6 percentage point higher than it would if the US economy were

Figure 2
United States: Import Volume During Economic Recovery



[a] Based on 1980 prices.
Source: Projected data from DRI (control 032684).

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stagnant (see table 5 and inset). Moreover, the continuation of US economic growth alone will help generate nearly three-quarters of a million more jobs in the Big Six countries. As in 1983, the Canadian and Japanese economies will gain the most. The four major West European countries will experience on average about one-half percentage point more economic growth annually during the 1984 to 1986 period because of US economic expansion.

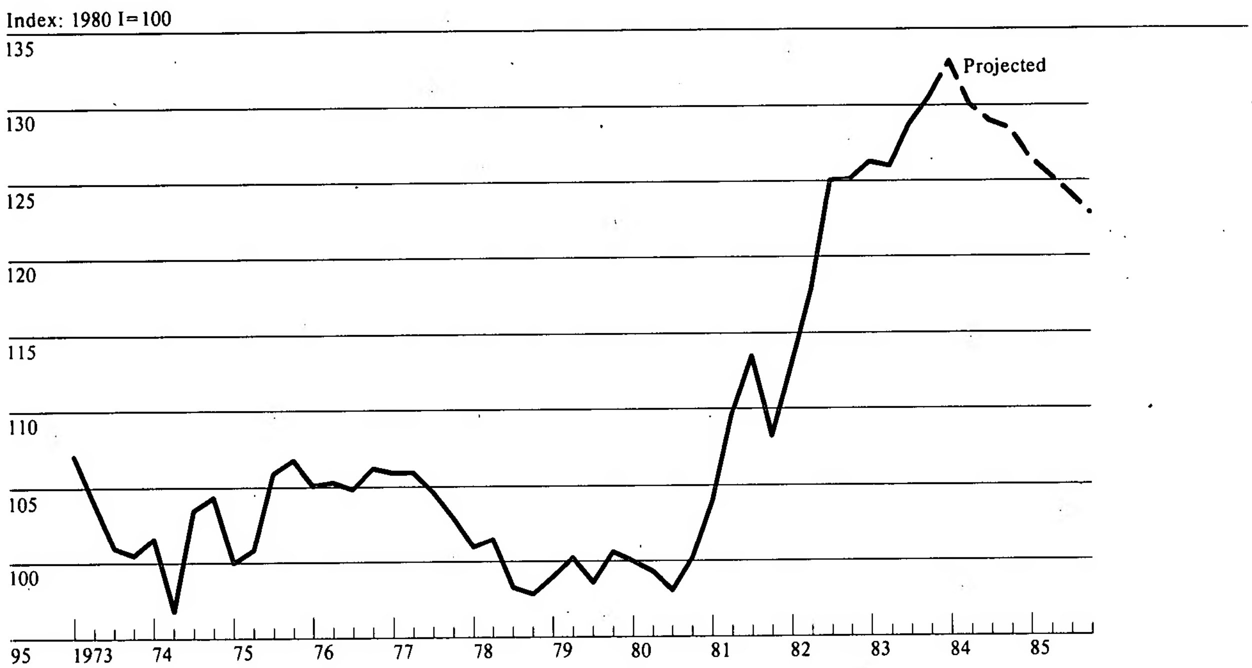
According to the LPIM, continued growth in the United States will mean almost an additional $100 billion in Big Six nominal exports to the United States during the 1984 to 1986 period. In 1986, we estimate US imports from the Six will be 31 percent greater in value terms and 29 percent in volume over the levels that would have existed if US growth were zero. With shares of the US market expected to stay roughly the same, the pattern of trade benefits is much the same as in 1983. In dollar terms, Canada and Japan take the lion's share while West Germany and the United Kingdom take the biggest slice of the balance, reflecting their relatively large stakes in the US market compared with France and Italy. 25X1

Manufactures should remain the fastest growing category of imports from the Big Six; a rebound in US oil demand may also reverse the cuts in energy sales experienced by Britain and Canada in 1983. The sharp drop in US steel imports in 1983 will not be repeated, and, within the limits of the European and Japanese voluntary restraints, steel imports from these sources will probably rise a bit. Continued strength in US auto demand will benefit the Canadian and European automakers as well as those of Japan which have higher quotas. In addition, Big Six exports of machinery, electronics, and consumer goods will gain from growth in US industrial production and consumer spending. 25X1

The impact of US recovery on each of the Big Six economies will be substantial over the next three years. The cumulative boost for Canadian and Japanese real GNP will reach 5.0 and 2.8 percentage points, respectively. Among the other four, Italy with a cumulative 1.7-percentage-point gain and Britain with 1.5 percentage points will be the big winners; even the 0.9-percentage-point gain for West Germany will be a major contribution to its economic performance. 25X1

The cumulative effect of the projected US growth over the three-year period leads to a much larger positive impact on employment than occurred in the 1983 scenario. By 1986, the US recovery will generate an estimated 730,000 additional jobs in the Big Six countries, resulting in a 0.6 percentage point lower unemployment rate compared to what it would be if US growth stagnates. Canada will receive the largest GNP boost and experience the greatest decline in the unemployment rate—down 1.5 percentage points in 1986. The unemployment rate in the other countries would be lower by between 0.4 and 0.6 percentage points in 1986. 25X1

Figure 3
United States: Inflation-Adjusted Trade Weighted US Dollar



Source: Projected data from DRI (control 032684).

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The impact of the US recovery in the Big Six can be clouded somewhat if the value of the dollar drops more rapidly than the DRI base forecast. A sharper depreciation of the dollar would make Big Six goods less competitive in US markets, thereby causing a cutback in US imports and lower GNP growth in the Big Six. As with an appreciation, however, the economic impact of a depreciation would take roughly two years to work fully through the system.

Implications

The United States, with its vigorous economic growth, is playing a leading role in stimulating Big Six economic recovery, particularly for Canada and Japan. The major West European economies, however, face tough, fundamental economic problems that require mainly domestic solutions; thus the US recovery can be of only limited help. Nonetheless, the gains in exports, GNP, and employment accruing to the West European economies from the continuing US recovery can be viewed as seed money which will provide an economic cushion for these countries as they attempt to restructure their industrial base and grapple with unemployment problems. 25X1

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Taken by themselves, the positive trade benefits of the US recovery should help to mute foreign criticism of US economic policies. Much of the criticism has come from the West Europeans. They argue that their

Table 5
Big Six: Impact of US Recovery, 1984-86 [a]

		Big Six	Japan	West Germany	France	United Kingdom	Italy	Canada
US Imports from Big Six (*billion US $*)	1984	14.2	4.7	1.4	0.7	1.2	0.5	5.7
	1985	32.0	10.0	3.2	1.6	2.7	1.2	13.3
	1986	51.4	16.2	4.9	2.4	4.8	1.8	21.3
US Import Volume from Big Six [b] (*percent*)	1984	10.4	10.2	10.1	10.1	11.8	10.2	10.5
	1985	20.3	20.0	20.1	20.1	21.0	20.1	20.6
	1986	28.8	27.5	28.1	28.4	29.2	28.3	30.1
Employment [b] (*thousands*)	1984	204	16	51	40	38	20	39
	1985	515	32	111	92	100	52	128
	1986	730	39	153	112	150	78	198
Real GNP (*percentage points*)	1984	0.7	1.1	0.4	0.5	0.6	0.5	1.6
	1985	0.8	1.1	0.3	0.5	0.6	0.7	1.6
	1986	0.4	0.6	0.2	0.1	0.3	0.5	1.8

[a] Net difference between the LPIM baseline forecast for 1984-86 and a scenario assuming zero US growth in each year.
[b] Data are cumulative.

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domestic interest rates have been pulled up by high rates in the United States with an adverse impact on their domestic investment and that import prices have risen because of the appreciation of the dollar. Despite these concerns, West European leaders increasingly realize that rapid US growth is helping stimulate their economies. In recent conversations with the US Embassy staff, French Finance Minister Delors, one of the most vocal critics in the past, has praised the US recovery as the motor of world growth. Even the strength of the dollar has had some positive effects by helping boost exports to the United States and giving their goods a price edge vis-a-vis US goods in third-country markets. Nevertheless, the recent rise in US interest rates appears likely to overshadow the positive benefits from economic recovery.

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Improved export performance in the Big Six countries is not likely to appreciably reduce protectionist pressures abroad. Most of the increase in US purchases has benefited Canada and Japan rather than Western Europe, where protectionist trends are the strongest. In turn, the growing Canadian and Japanese economies offer little help to West European export growth. Moreover, the West European industries demanding import restraints—textiles, steel, basic machinery, and shipbuilding—are the least competitive internationally and, hence, have gained little from the US recovery.

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Estimating the Impact of the US Recovery in the 1984 to 1986 Period

As in our analysis of 1983, we used the LPIM to analyze the impact of the US recovery on the Big Six economies over the next few years. We incorporated the most recent Data Resources, Inc. (DRI) forecast for US economic growth (CONTROL 032684) to establish a baseline forecast of Big Six economic activity. According to DRI, the US economy will advance 5.3 percent in 1984, 3.2 percent in 1985, and 2.6 percent in 1986. The DRI forecast assumes a gradual 10-percent depreciation of the dollar over the three-year period. To isolate the impact of the US recovery on the Big Six economies, we compared our baseline results with an LPIM simulation that held US real growth to zero over the period—all other independent variables were unchanged in the two scenarios. 25X1

The added stimulus to Big Six economic growth caused by the US recovery will indirectly help the trade position of debt-troubled LDCs. Slow—in some countries, negative—economic growth in the Big Six last year led to a 6-percent decline in the volume of Big Six purchases from LDCs; in dollar terms, imports dropped by 11 percent. As a result, the Big Six intensified LDC debt problems, rather than help alleviate them. To the extent that the US recovery prompts more economic growth in the Big Six, their imports from LDCs should expand. 25X1